DEC 1

In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 74-1110

EASTERN KENTUCKY WELFARE RIGHTS ORGANIZATION, ET AL.,
Petitioners
v.
WILLIAM E. SIMON, SECRETARY OF THE TREASURY, ET AL.,
Respondents

No. 74-1124

WILLIAM E. SIMON, SECRETARY OF THE TREASURY, ET AL.,
Petitioners
v.
EASTERN KENTUCKY WELFARE RIGHTS ORGANIZATION,
Respondents

On Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF FOR THE PETITIONERS IN 74-1110

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REPLY BRIEF FOR THE PETITIONERS IN 74-1110

I. NON-TAXPAYERS MAY SEEK JUDICIAL REVIEW OF IRS RULINGS.

1. Defendants' primary contention is that non-taxpayers cannot seek review of IRS rulings even without regard to the Anti-Injunction Act, 26 U.S.C. § 7421(a)

(Def. Br. 27-48). Defendants' arguments against reviewability, however, portray a profound misunderstanding of administrative law.

In essence, defendants posit three reasons why nontaxpayers should not be permitted to seek review of IRS rulings absent express statutory authority. First, Congress has given the Secretary of the Treasury, as opposed to all other government officials, extensive authority in the areas of rulings and refunds (Def. Br. 35-42). Second, Congress has given the Secretary and the Commissioner the power to prescribe "all needful rules and regulations" for the enforcement of the Internal Revenue Code (Def. Br. 38). Third, the Secretary and the Commissioner have special expertise in carrying out this "discretionary rule-making responsibility" (Def. Br. 38-39).

The difficulty with defendants' position is that virtually every federal agency could make the same arguments in favor of non-reviewability. Virtually every agency has tasks for which it, and no other part of the executive branch, is solely responsible.[1] Virtually every agency with regulatory authority has been provided by Congress with the power to make all necessary rules and regulations.[2] And, of course, every agency can legitimately lay claim to expertise in its particular field.

[1] Defendants argue that *a fortiori* private parties cannot set aside the actions of the Commissioner because under section 6406 no other administrative or accounting officer of the United States can set aside his actions (Def. Br. 41-42). There is nothing *a fortiori* about it. The fact that Congress gives one executive official final authority within the government over a matter does not mean that private parties cannot seek judicial review of the official's actions.

[2] *See, e.g.*, 15 U.S.C. § 46(g) (Federal Trade Commission); 29 U.S.C. § 657 (Secretary of Labor under the Occupational Health and Safety Act); 33 U.S.C. § 1172(a) (Secretary of Interior under the Water Pollution Control Act); 46 U.S.C. § 876(i) (Secretary of Commerce under the Merchant Marine Act); 47 U.S.C. § 303(f) (Federal Trade Commission).

Under defendants' reasoning, therefore, agency actions would never be reviewable absent an express statutory provision. But such reasoning turns administrative law on its head. Judicial review of administrative action is the rule, and non-reviewability is the exception which requires congressional approval.[3]

Defendants appear to be confused about the most basic tenets of administrative law. They stress "the constitutional and statutory commitment to vest the administration of the revenue law exclusively in the Executive Branch" (Def. Br. 44). But the administration of *all* laws rests exclusively in the executive branch. Judicial review of agency action is not tantamount to administration of the laws, whether they be revenue laws, securities laws or drug laws. Courts are not administering the laws when they seek to assure that the executive branch is complying with congressional mandates.

In effect, defendants seek to amend the judicial review provisions of the Administrative Procedure Act to secure an exemption for the IRS. But only Congress can provide such an exemption. The Court should make clear that the IRS is bound by the Administrative Procedure Act.

2. Defendants seek to buttress their attack on reviewability with several inaccurate assertions. First, defendants assert that plaintiffs seek retroactive revocation of a revenue ruling and that such revocations would create widespread uncertainty (Def. Br. 34-35). But, of course, plaintiffs have no interest whatsoever in retroactive revocation of Revenue Ruling 69-545. Plaintiffs are concerned with the future conduct of non-profit hospitals, not with past tax liabilities.

[3] *See, e.g., Barlow* v. *Collins*, 397 U.S. 159, 166-167 (1970); *Abbott Laboratories* v. *Gardner*, 387 U.S. 136, 141 (1967); *Rusk* v. *Cort*, 369 U.S. 367, 379-80 (1962).

More generally, the IRS would be as free to revoke rulings prospectively after successful suits by non-taxpayers as it is after successful suits by taxpayers. Thus, non-taxpayer suits would not increase uncertainty. Indeed, far more uncertainty is created by the massive number of taxpayer suits than would be created by the rare non-taxpayer suit.[4] In short, defendants' retroactivity argument is baseless.

Defendants also assert that litigation such as plaintiffs' could be used to compel the IRS to audit a particular taxpayer or to impose a heavier tax burden on a competitor (Def. Br. 44). This is obviously untrue. Plaintiffs do not and could not seek to compel the IRS to take action against any particular taxpayer.[5] They do not and could not seek to establish priorities for the IRS in the enforcement of the tax laws. Plaintiffs simply seek invalidation of a general ruling in the expectation that under our "self-reporting tax system" (Def. Br. 30) invalidation of the ruling will itself alter hospital conduct. It will be up to the IRS and the IRS alone to determine how much resources to devote to assuring that particular hospitals comply with a valid revenue ruling. Thus, this litigation does not derogate from the IRS' "prosecutorial discretion."

Finally, defendants suggest that the jurisdictional holdings of the Court of Appeals would jeopardize the letter rulings program by inviting anyone who disagreed with

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[4] Taxpayer suits often overturn IRS rulings and even regulations. See, *e.g.*, *United States* v. *Cartwright*, 411 U.S. 546 (1973).

[5] The relief which was accorded to plaintiffs by the District Court was the invalidation of Revenue Ruling 69-545 and a requirement that defendants direct tax-exempt hospitals to post notification of "free service." This relief does not require defendants to prosecute anyone. Although the Complaint also requested an order compelling defendants to collect taxes due and owing from hospitals which refused to serve the poor, that relief was not ordered, and plaintiffs did not seek such relief on appeal.

a letter ruling to sue (Def. Br. 34-35). But the number of letter rulings which might be challenged by non-taxpayers is miniscule. A suit involving letter rulings is infinitely more likely to come from a taxpayer who brings a refund suit seeking the same favorable ruling a competitor received. See, *e.g.*, *IBM* v. *United States*, 343 F.2d 914 (Ct.Cl. 1965), *cert. denied*, 382 U.S. 1028 (1966).

Defendants' attempts to broaden the reach of the Anti-Injunction Act are without merit. Defendants argue that the Anti-Injunction Act bars judicial interference "with the *process* of collecting" taxes (Def. Br. 61, emphasis in original), and that the "process" of tax collection includes promulgation of the revenue ruling at issue here. This argument proves too much. Any suit against the IRS, including suits challenging the agency's employment policies or its domestic surveillance policies, can be said to interfere with the "process" of collecting taxes. But, surely, such suits are not barred by the Anti-Injunction Act.

Defendants argue once again that challenges to revenue rulings might curtail the agency's activities "in other, more fruitful areas of enforcement, . . . to the detriment of the revenue collections" (Def. Br. 62). But as plaintiffs have already noted, p. 4 *supra*, their suit does not require the IRS to alter its enforcement priorities, but leaves the IRS free to deploy its enforcement resources in any rational manner it chooses.

Finally, defendants claim that it would be anomalous for Congress to permit this suit when it bars injunctive actions by taxpayers (Def. Br. 63). But Congress has provided taxpayers with other judicial remedies. It is not anomalous for Congress to provide some means of judicial review for all aggrieved persons, taxpayers and non-taxpayers alike.

4. Defendants argue that the tax exception to the Declaratory Judgment Act, 28 U.S.C. § 2201, is broader than the Anti-Injunction Act (Def. Br. 63). But defendants fail to suggest why Congress would bar declaratory relief in situations where it did not bar injunctive relief.[6] And, significantly, defendants do not even attempt to argue that the Declaratory Judgment Act somehow broadened the Anti-Injunction Act. (See discussion in plaintiffs' principal brief, 53-56).

5. Defendants assert that the doctrine of sovereign immunity applies because plaintiffs do not complain that the Secretary or the Commissioner acted beyond their statutory powers (Def. Br. 73). This is incorrect. Plaintiffs do complain that it is beyond the defendants' statutory powers to promulgate Revenue Ruling 69-545 without following the Administrative Procedure Act and without adhering to Section 501(c)(3) of the Internal Revenue Code.

Defendants fail to confront plaintiffs' Administrative Procedure Act claim at all. With respect to plaintiffs' Section 501(c)(3) claim, defendants imply that when the Commissioner erroneously interprets a term of the statute and acts upon that interpretation, he is not acting beyond his statuory powers (Def. Br. 73). Under this reasoning, the Commissioner would not be acting beyond his statutory powers if he granted a charitable exemption to General Motors; he would simply be making an erroneous interpretation of the statute. Defendants are advancing an erroneous interpretation of the sovereign immunity doctrine.

6. The common thread that runs through all of defendants' jurisdictional points is that non-taxpayer challenges to rulings would disrupt the IRS and burden the

[6] There may be situations where declaratory relief is permitted even though injunctive relief is barred. *See, e.g., Steffel* v. *Thompson*, 415 U.S. 452 (1974).

courts. But, as plaintiffs have emphasized, the number of non-taxpayer suits is miniscule compared to the massive number of taxpayer suits with which IRS and the courts must cope. In fiscal year 1975 over 12,500 tax suits were filed in federal district courts, the Tax Court and the Court of Claims.[7] By contrast, defendants can point to only 15 non-taxpayer suits filed in the last five fiscal years (Def. Br. 47 n. 79). Defendants are straining at gnats while swallowing camels.

II. PLAINTIFFS HAVE STANDING TO SEEK JUDICIAL RELIEF FOR THE DEFENDANTS' VIOLATIONS OF LAW.

The District Court and the Court of Appeals correctly held that plaintiffs have standing to seek judicial resolution of the violations with which they charge defendants (Pl. Pet. 38a-48a, 12a n. 6). The defendants contend otherwise in this Court. They claim that plaintiffs are seeking review of a prosecutorial decision (Def. Br. 50-53). They also contend that plaintiffs lack standing under this Court's "zone of interest" and "injury in fact" tests for standing (Def. Br. 53-57). All three contentions are incorrect.

(A) Plaintiffs are not seeking review of a prosecutorial decision.

Defendants rely on the decision in *Linda R.S.* v. *Richard D.*, 410 U.S. 614 (1973), in which this Court held that "a private citizen lacks a judicially cognizable interest in the prosecution or non-prosecution of another." 410 U.S. at 618. But defendants' reliance on *Linda R.S.* is misplaced. The Court in *Linda R.S.* emphasized that

[7] These statistics were obtained through telephone conversations with personnel at the Information Systems Division of the Administrative Office of the United States Courts, the Clerk's Office of the Court of Claims and the Statistics Division of the Tax Court.

its holding on standing occurred "in the unique context of a challenge to a criminal statute." 410 U.S. at 617. The Court spoke of the "special status of criminal prosecutions in our system." *Ibid.* It implied that plaintiff would have had standing to compel initiation of a civil contempt proceeding.[8]

The instant case does not involve a criminal prosecution. More significantly, as discussed above, pp. 4-5 *supra*, it does not involve prosecutorial discretion at all.

(B) Plaintiffs satisfy the "zone of interest" and "injury in fact" tests.

Plaintiffs are seeking judicial resolution of claims that defendants deprived them of their rights under two federal statutes: the charitable provisions of the Internal Revenue Code (26 U.S.C. § 501(c)(3) and § 170(a)-(c)); and the requirements for rulemaking under the Administrative Procedure Act (5 U.S.C. § 553). A long line of recent decisions recognize the standing of persons, arguably within the zone of interests of federal legislation, to sue for a deprivation of statutory rights. Such persons are aggrieved parties within the meaning of § 10 of the Administrative Procedure Act and have been conferred standing by Congress.[9]

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[8] The Court more recently drew a distinct line between an action to compel a criminal prosecution (such as in *Linda R.S.*) and an action to require agency performance of duties owed to individual citizens under civil statutes, albeit governmental interests are also necessarily involved. *Dunlop* v. *Bachowski*, —— U.S. ——, 95 S.Ct. 1851 (1975), affirming the holding of the Court of Appeals on this point quite explicitly (at n. 7).

[9] See, *e.g.*, *Abbott Laboratories* v. *Gardner*, 387 U.S. 136 (1967); *Association of Data Processing Service Organizations* v. *Camp*, 397 U.S. 150 (1970); *Barlow* v. *Collins*, 397 U.S. 159 (1970); *United States* v. *S.C.R.A.P.*, 412 U.S. 669 (1973); *cf. Trafficante* v. *Metropolitan Life Insurance Co.*, 409 U.S. 205 (1972).

Zone of Interests

The Complaint alleges that individual plaintiffs and members of organizational plaintiffs are poor persons, with incomes below the poverty guidelines, suffering from medical conditions requiring hospital services but lacking the means to pay for such services (A. 12-14).[10] Suing on behalf of themselves or their members, and all other persons in similiar circumstances, they claim that they are intended to be protected by, and are beneficiaries of, the "charitable" provisions of the Internal Revenue Code (A. 13).

Poor people needing hospital services but lacking the means to pay are clearly within the zone of interests of legislation conferring special benefits upon hospitals as "charitable organizations." A primary purpose of section 501(c)(3) charitable exemptions is to encourage private efforts to assist the poor. Indeed, defendants' own regulation defines "charitable" in the first instance as "relief of the poor and distressed or of the underprivileged." 26 CFR 1.501(c)(3)-(1)(d)-(2).

Defendants contend that "no provision of the Internal Revenue Code creates . . . a private right of action or a protectable zone of interests" (Def. Br. 56 n. 31). But the decisions of this Court do not require a specific statutory authorization. Rather, the language of the statute and/or its legislative history is construed to determine whether Congress intended, explicitly or implicitly, that certain persons be protected or benefitted by the legislation. Plaintiffs were meant to be benefitted by section 501(c)(3) and thus are within its zone of interests.

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[10] Other allegations give specific circumstances surrounding plaintiffs' economic status, their medical problems, and unsuccessful attempts to obtain hospital services (A. 17-24). Affidavits supplied by them and others, including physicians serving the poor, further amplify their individual situations (A. 78-144).

Plaintiffs are also within the zone of interests of the rulemaking requirements of the Administrative Procedure Act (5 U.S.C. § 553).[11] Persons who may be adversely affected by an agency rule are entitled to have the agency promulgate the rule in accordance with the procedures Congress determined would be fair.[12] Since plaintiffs may be adversely affected by Revenue Ruling 69-545, they are intended beneficiaries of section 553 and are within its zone of interests.

Injury in Fact

Defendants contest the findings of the District Court and the Court of Appeals that plaintiffs have been injured in fact by the deprivation of their statutory rights. In advancing this contention, defendants assert that here is no correlation between the Treasury ruling and either the injuries which plaintiffs have suffered or the relief which plaintiffs would hope to receive from a favorable judicial order. This is incorrect.

Plaintiffs are poor people who have attempted to receive and have been expressly denied necessary hospital care because they could not afford to pay.[13] Under the

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[11] Defendants do not discuss plaintiffs' standing to raise the deprivation of their rights under the rulemaking requirements of the Administrative Procedure Act.

[12] As recognized by this Court in *NLRB* v. *Wyman-Gordon*, 394 U.S. 759, 764 (1969): "The rulemaking provisions . . . were designed to assure fairness and mature consideration of rules of general application" (plurality opinion).

[13] For example, in January 1971 plaintiff Artie Tackett, who had suffered two heart attacks, attempted to get admitted to Prestonburg General Hospital (a non-profit hospital in Floyd County, Kentucky, accorded 501(c)(3) status by defendants). When the Tacketts told the nurse that they did not have the $50 requested for admission deposit, the nurse tore up the admission application (A 81, 82). In June 1971 representatives of plaintiff Eastern Kentucky Welfare Rights Organization, on behalf of their indigent members, met with officials of the Pikesville Methodist Hospital,

prior revenue ruling, hospitals would have been required to afford poor people free care as a condition of retaining tax-exempt status. In order to retain the tax-exempt status, the hospitals would have provided free care to plaintiffs and others similarly situated.[14]

Pike County, Kentucky (another non-profit hospital accorded 501(c)(3) status by defendants) to discuss hospital admission policies. They were flatly told that if their members do not have the money, they do not get in (A 79-80). Plaintiffs Cook, Lampton and Hunter have all been told by admitting personnel at various non-profit 501(c)(3) hospitals in the New Orleans area that they do not serve persons unable to pay (A 99, 104, 113).

Defendants suggest that a closer examination of plaintiffs' affidavits reveals a number of refusals to admit Medicaid beneficiaries, and that Revenue Ruling 69-545 requires that non-profit hospitals admit patients whose care will be paid "with the aid of public programs such as Medicare" (Def. Br. 54 n. 30). But defendants do not understand the workings of the Medicaid program. As plaintiffs have already discussed in their principal brief, Medicaid is a federal-state program, and eligibility is determined on the basis of state criteria, which severely limit the income levels for eligibility as well as services provided. While plaintiff Hunter was eligible for Medicaid in June 1970, when she first attempted to gain admission into 501(c)(3) hospitals which refused to treat the poor (A 104), a slight increase in her income by January 1973 (A 91) made her and her four children ineligible; Louisiana cuts off eligibility for a family of four with an income above $1464 a year (See Pl. Pet. 78a). Two of her children have acute sickle cell anemia (A 91) but cannot obtain services from the New Orleans non-profit hospitals. Further, Louisiana has a fifteen-day limitation for hospitalization, so that persons such as plaintiffs Cook and Lampton (even if still eligible for Medicaid) lose Medicaid coverage once they have exhausted the fifteen days each year (CCH Medicare & Medicaid Guide ¶ 15,592), and plaintiff Cook's illnesses have required more than fifteen days' hospitalization (A 90).

[14] Plaintiffs, of course, are not required to demonstrate that they, as opposed to other poor people in their local hospitals' service areas, would definitely have received free care under the prior ruling. It suffices that they are in the class of people who would receive free care. Similarly, a black person who challenges discrimination in employment need not demonstrate that he, as opposed to all other applicants, would have gotten the job at issue; he merely has to show that he was one of the qualified persons the employer should have considered.

Defendants suggest that plaintiffs would not be better off under the old revenue ruling because hospitals might well forgo their tax-exempt status rather than provide free care, particularly since private philanthropy has declined to only four percent of hospital revenue (Def. Br. 55). Defendants' speculations are unfounded. Defendants ignore the fact that 60 per cent of hospital construction and modernization monies have their origin in "charitable" contributions.[15] The American Hospital Association itself has emphasized how important charitable contributions are to non-profit hospitals.[16] Further, as pointed out by *Amicus* Jackson County, Missouri, Revenue Ruling 69-545 serves as an important criterion for states and their subdivisions in determining local tax exemptions. (Jackson Br. p. 8). Hospitals are not

[15] For example, in 1969, the year in which defendants issued revenue ruling 69-545, $1.5 billion in charitable contributions were made to hospitals for construction or modernization, and this $1.5 billion represented 60% of the total $2.5 billion spent on construction that year. See Hearings on Medicare and Medicaid before the Subcomm. of Medicare-Medicaid of the Senate Comm. on Finance, 91st Cong. 1st Sess., p. 422 (1969).

[16] The President of the American Hospital Association, in testimony before the House Ways and Means Committee, stated:

> "I appear today to express to the committee our concern with any action the committee might take, in connection with its current consideration of tax reform, which could jeopardize or in any way inhibit charitable contributions to the Nation's voluntary nonprofit hospitals. . . . Voluntary nonprofit hospitals are, in varying degrees, dependent upon charitable contributions. . . . A basic incentive to the donations spelled out in the IRS Code are benefits and income tax deductions which have been granted by the States since the inception of the Republic and by the Federal Government following the enactment of the Federal income tax laws. . . . We also believe strongly that existing tax preferences for such donations are the single most important incentive for people to continue to support charitable enterprises." Statement of John Alexander McMahon, President, American Hospital Association, Public Hearings on General Tax Reform, before the Committee on Ways and Means, House of Rep., 93rd Cong., 1st Sess., April 13, 1973, pp. 6349-50.

likely to give up their property tax exemptions and pay hundreds of thousands (or millions) of dollars of tax revenue to states, counties, and municipalities.

Defendants also argue that nothing in the prior revenue ruling "would prevent a private hospital from using its surplus funds for research or capital expenditures rather than for admission of the indigent." (Def. Br. 54-55). This is simply an incorrect reading of Revenue Ruling 56-185, which states that a hospital

> ". . . must be operated to the extent of its financial ability for those not able to pay for the services rendered and *not exclusively for those who are able and expected to pay*. . . . It may also set aside earnings which it uses for improvements and additions to hospital facilities. *It must not, however, refuse to accept patients in need of hospital care who cannot pay for such services.*" (Pl. Br. 7a-8a. Emphasis added)

In short, under the prior ruling, hospitals did have to serve the poor.[17]

Warth v. *Seldin*, —— U.S. ——, 95 S.Ct. 2197 (1975), relied on by defendants, is inapposite here. In *Warth* the Court concluded that "petitioners' description of their individual financial situations and housing needs suggests . . . that their inability to reside in Penfield is the

[17] That the prior ruling in fact forced hospitals to afford free care is demonstrated by the American Hospital Association's strenuous efforts to eliminate the free care requirement through legislation (see plaintiffs' principal brief 25-26). One of the reasons AHA gave for its proposal before the House Ways and Means Committee was alleged harrassment by IRS of hospitals for not giving enough free care. (Hearings on Tax Reform Act of 1969, H.R. 13270, before the House Committee on Ways and Means, 91st Cong., 1st Sess. 1425, 1429, 1438 (1969)). In the summer of 1969, shortly before Revenue Ruling 69-545 issued, such efforts by IRS local officials in Ohio precipitated the *Harding Hospital* case. (See *Harding Hospital, Inc.* v. *United States*, 358 F.Supp. 805, 806 (S.D. Ohio 1973), *aff'd*, 505 F.2d 1068 (6th Cir. 1974).

consequence of the economics of the area housing market, rather than of respondents' assertedly illegal acts." 95 S.Ct. at 2209. By contrast, plaintiffs here contend that a primary purpose of the charitable exemption policy of sections 501(c)(3) and 170 is to ameliorate the economic rigors of the marketplace and that defendants' illegal actions deprive them of the benefits of that policy.

III. NON-PROFIT HOSPITALS MUST SERVE THE POOR AS WELL AS THE RICH IN ORDER TO RETAIN THEIR "CHARITABLE" STATUS UNDER THE CODE.

Plaintiffs' basic contention is that the defendants violated the Internal Revenue Code when they eliminated the requirement that hospitals must serve the poor as well as the rich in order to retain their "charitable" status under the Code (Pl. Br. 14-39). Defendants, while acknowledging that "service to the poor" was given more emphasis in the Treasury's initial administration of the "charitable standard" for hospitals (Def. Br. 88), justify their departure from the prior rule on four grounds: (1) that the current Treasury regulation permits them to eliminate the requirement, and in effect recognize non-profit health organizations as charitable *per se* (Def. Br. 83-84); (2) that the "generally accepted legal sense" of the application of charitable to hospitals under state law has evolved away from the "poor as well as the rich" requirement (Def. Br. 86); (3) that social and economic changes support the elimination of the free service requirement in favor of a policy of general service to all who can pay, and only emergency room service to the poor (Def. Br. 92-95); (4) that the prior rule was administratively unworkable (Def. Br. 95-96). In all respects defendants are mistaken.

1. As demonstrated in plaintiffs' principal brief, there is nothing in the 1969 Treasury regulation or in its

published history to indicate that anyone contemplated elimination of the requirement that charitable institutions must either serve only the poor or must provide services to the entire relevant community, rich and poor alike [18] (Pl. Br. 17-18). Except with respect to hospitals, defendants themselves continue to insist that charitable organizations serve the poor either exclusively or along with respect of the relevant community. Every one of the innumerable organizations which are the subject of the revenue rulings cited by defendants (Def. Br. 90, n. 55) and the American Hospital Association (AHA Br. 20, n. 19; 33-34, n. 34) in fact provide service to the relevant community without regard to ability to pay or else fit into one of the other specific classifications set forth in section 501(c)(3).[19]

Defendants suggest that the exception for hospitals is justified because promotion of health care is recognized as an accepted charitable activity (Def. Br. 87 n. 52). But that statement is an oversimplification. Health care in this country is promoted by individuals and institutions which are most assuredly not charitable. For the most part the public relies for its health care services on private practitioners whose income comes from the fees they collect from each of their patients. The drug

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[18] Plaintiffs use the term "relevant community" because it is clear that charitable institutions can serve specific segments of the community, *e.g.*, children, the elderly, drug addicts, etc.

[19] Reference to all the cited rulings reveals that either the ruling on its face makes it clear that the service is provided to all persons, rich and poor, or the service is provided solely to the poor, is educational (IRS has always characterized theater, music, and art programs under the educational category), protects animals, or promotes public safety. The only possible exception is a 1972 ruling involving homes for the aged (Rev. Ruling 72-124). But even this ruling recognizes that a charitable home must provide "financial security" to the elderly and suggests that rates below customary charges may be necessary for at least some of the residents (1972-1 Cum. Bull. 145).

industry, an integral part of the healing process, is big business. Most non-profit hospitals, like for-profit hospitals, do not have their own medical staffs but rely on and generate income for private practitioners who bill patients on a commercial fee-for-service basis.

In short, the fact that non-profit hospitals promote health care does not automatically qualify them as "charitable." Non-profit hospitals, like other non-profit organizations, are only charitable when they serve the poor, either exclusively or as part of the relevant community.

2. Contrary to the position urged by the defendants and the American Hospital Association (AHA), the generally accepted legal sense of the word "charitable" as applied to hospitals under state case law has been, and continues to be, that hospitals must be open to all, regardless of ability to pay, in order that they be considered "charitable." This basic requirement appears throughout, in the cases which plaintiffs cite in their principal brief (Pl. Br. 29-30), the cases which defendants cite in their brief (Def. Br. 86 n. 51) and the cases which AHA cites in its brief (AHA Br. 25-29).[20] This is not archiac law as suggested by defendants and the AHA. For example, *Burgess* v. *Four States Memorial Hospital*, 250 Ark. 485, 465 S.W. 2d 693 (1971) and *Jackson County* v. *State Tax Commission*, 521 S.W. 2d 378 (Mo. 1975), represent recent, detailed statements that service to rich *and poor* alike is still a requirement for "charitable" hospitals under the laws of those states.

Most of the cases which defendants and AHA cite for the proposition that health is charitable *per se* focus on the question of the hospital's non-profit status, and

[20] The same requirement is contained in the cases which Professor Scott cites in support of the "charitable *per se*" statement which defendants borrowed in Revenue Ruling 69-545. *See also*, Comment, *Hospitals, Tax Exemption and the Poor*, 10 Harv. Civ. Rights-Civ. Lib. L. Rev. 653, 679 (1975).

an examination of the opinions demonstrates that the courts were operating on the assumption that the doors of the hospitals were open to all. *E.g.*, *City of Richmond* v. *Richmond Memorial Hospital*, 202 Va. 86, 116 S.E. 2d 79 (1960). See also opinion in *Jackson County*, *supra*, where the Supreme Court of Missouri noted that, while some Missouri courts had used language which would suggest that health is charitable *per se*, that is not the state of the law in Missouri:

> "Not one of such cases, however, has reached a decision solely within the limitations of such words, and an abbreviated reference to the standard can be found only in those instances where all of the appendages, i.e., *available to all, rich or poor* . . . were not particularly significant or a controlling factor in disposition of the case." (emphasis supplied).

There are a few cases which do not require free care from hospitals as charitable institutions, but a closer examination of most of those cases reveals that the state specifically included non-profit hospitals as a category for tax exempt status by name, e.g., New York (*People ex rel. Doctor's Hospital* v. *Sexton*, 267 App. Div. 736, 48 N.Y.S.2d 201 (1944)). Congress rejected this very same separate categorization as an amendment to sections 501(c)(3) and 170(c) in 1969 (see Pl. Br. 25-28).[21]

[21] Aside from their reliance upon an alleged trend of state case law, defendants assert that Revenue Ruling 69-545 is justified under the general proposition "that the law of charitable trusts has always included a category for purposes beneficial to the community" (Def. Br. 87). Plaintiffs do not take issue with that statement, but note that under the common law, the services of the charitable organization must be available to *all* persons, rich and poor alike, unless the organization comes within one of three specified heads of charity (relief of the poor, education, or religion) and health is not one of these heads. In this respect, the oft-cited common-law definition of Lord McNaughten provides:

> "Charity in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of

3. Defendants also justify their "modification" of the law on the same basis which they sucessfully urged upon the Court of Appeals, i.e., that the requirement of free care to the indigent "fails to recognize the changing economic, social and technological precepts and values of contemporary society" (Def. Br. 93). However, they totally ignore the fact that Revenue Ruling 69-545 contained no such conclusion.[22] They contend that the Ruling demonstrates a concern with the needs of the poor, by requiring free emergency room care (Def. Br. 89), but proffer no empirical evidence to demonstrate the basis upon which the Internal Revenue Service, which lacks expertise in health affairs, could come to a conclusion that the poor no longer need free inpatient care.[23]

4. Defendants also take the position that the indigent care requirement of Revenue Ruling 56-185 is adminis-

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education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads. The trusts last referred to are not the less charitable in the eye of the law, because incidentally they benefit the rich as well as the poor, as indeed, every charity that deserves the name must do either directly or indirectly." *Commissioners for Special Purpose of Income Tax* v. *Pemsel* (1891) A.C. 531, 583.

[22] The elimination of the free care requirement in Revenue Ruling 69-545 was predicated solely upon the law of charitable trusts (itself erroneously stated—pp. 16-17 *supra*). Defendants do not respond to the admonition in decisions of this Court that an appellate court cannot substitute its own determination of policy, or the *post hoc* rationalization of appellate counsel, for the grounds relied upon by the administrative agency (Pl. Br. 30-31).

[23] Plaintiffs have demonstrated in their principal brief that the health system and health policy of this country still requires free inpatient care to the indigent in non-profit hospitals (Pl. Br. 31-37). They have been supported in this position by the *amicus* briefs of the American Public Health Association (APHA Br. 14-30) and Jackson County, Missouri (Jackson Br. 10-15). Defendants have totally failed to respond to the serious questions raised in all three briefs, that Revenue Ruling 69-545 has deprived millions of poor people, without any public or private health insurance, of access to inpatient hospital services.

tratively unworkable (Def. Br. 95). They argue that even a hospital with available surplus funds may need to modernize facilities or install new equipment and that the IRS cannot determine how much should be spent for these purposes rather than for free care. But in many other contexts defendants develop guidelines for assuring compliance with the law;[24] they can do so here. Moreover, they can make use of HEW's Hill-Burton regulations which also require hospitals to provide a reasonable volume of free care.[25]

The crucial point, as Revenue Ruling 56-185 recognized, is that a hospital may not modernize facilities and install new equipment solely for the benefit of those who can afford to pay.[26] A hospital that devotes all its re-

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[24] *See, e.g.*, Rev. Proc. 74-26, 1974-2 Cum. Bull. 478; Rev. Proc. 66-34, 1966-2 Cum. Bull. 1232; 26 CFR § 1.170A-9(e)(2); 26 CFR § 1.305-5(b)(2) which provide percentage guidelines to assure compliance with regulatory terms such as "substantially all," "substantial" and "reasonable." See also, 40 Fed. Reg. 53409, Nov. 18, 1975, in which IRS sets forth detailed guidelines to determine for purposes of section 501(c)(3) whether private schools have racially nondiscriminatory policies as to students.

[25] The Hill-Burton regulations require hospitals to provide free care equal to 10 per cent of their Hill-Burton grant or 3 per cent of cost of operations, or else certify that they turn no one away from inpatient and outpatient care. 42 C.F.R. 53.111(d). Similarly, the IRS could establish a guideline based on the percentage of the charitable contributions received by a hospital or its income, or else require that the hospital turn no one away.

In the context of §§ 501(c)(3) and 170(a)-(c), the financial ability of a hospital to provide free care is probably best measured in terms of the charitable contributions it receives. A hospital cannot argue that it is unfair to require it to spend a percentage, *e.g.*, 50 per cent, of the charitable contributions it receives to provide charitable services to the poor. If charitable contributions are used only to provide services to those who can afford to pay, there is, as *Amicus* Jackson County puts it, "a windfall to the affluent" (Jackson Br. 16).

[26] As noted above (p. 13, *supra*), Revenue Ruling 56-185 stated that a hospital could set aside earnings for improvements and additions provided that it "must not, however, refuse to accept patients in need of hospital care who cannot pay for such services."

sources to benefit persons who can pay for care is not providing charitable service and is not entitled to a § 501(c)(3) exemption.

IV. IRS PROMULGATION OF REVENUE RULING 69-545 VIOLATED THE RULEMAKING REQUIREMENTS OF SECTION 553 OF THE ADMINISTRATIVE PROCEDURE ACT.

Section 553 of the APA requires an agency to afford public notice and an opportunity for comment when the agency engages in substantive rulemaking. Defendants argue that Revenue Ruling 69-545 is an interpretative rule and, therefore, exempt from APA requirements (Def. Br. p. 97). Plaintiffs' principal brief showed that under the functional test courts apply to determine whether a rule is substantive or interpretative, this Ruling is substantive and thus subject to section 553 (Pl. Br. 42-49).

A functional test has the advantage of avoiding the semantic difficulties with which courts and commentators have long wrestled.[27] However, even relying on the definitional approach the defendants opt for, and recognizing further that, because of the impreciseness of the definitions, there is a substantial fringe area in which the distinction between substantive and interpretative rulings is blurred, Revenue Ruling 69-545 must be categorized as substantive.

Defendants take their definitions of "substantive" and "interpretative" from *Gibson Wine Co.* v. *Snyder*, 194 F.2d 329, 331 (D.C.Cir. 1952). There, the Court of Appeals for the District of Columbia Circuit stated that a substantive rule is one which "creates law" implementary to existing law while an interpretative rule is one in which an administrator announces an official agency position on the meaning of a particular term as used in a statute. These definitions parallel closely those offered by Congress when it created the exemption from section 553 for interpretative rules. The legislative history refers to a substantive ruling as a ruling which serves a statutory role because it involves subject matter demanding judgments based on technical knowledge and experience; it refers to an interpretative rule as an administrative construction of a statutory provision.[28]

The definitions from *Gibson Wine Co.* and from the legislative history carry the same import. An administrative interpretation is an agency decision as to what the agency thinks Congress meant when it enacted a statute. On the other hand, substantive rules address the problems and practicalities of implementing a statutory scheme. They provide the detail about how a program will work that Congress would provide if it had the time, organization and staff to do so. Substantive rules involve factual and value judgments to which agency expertise can make a substantial contribution. Comments from outsiders as mandated by section 553 help to ensure that all relevant information reaches the agency.

Defendants argue that the difference between the two types of rulings is that an interpretative ruling is not legally binding. The use of the term "legally binding" in this context is misleading. When used to refer to administrative rulings, it simply designates the standard for judicial review. Substantive rulings, because they involve agency expertise and require a comment period under section 553, are reviewed only for arbitrariness and are said to be "legally binding." Interpretative rulings are subject to plenary review and therefore are

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[27] *See, e.g., National Motor Freight Traffic Association, Inc.* v. *United States*, 268 F.Supp. 90, 96 (D.D.C. 1967); *Oil Shale Corp.* v. *Morton*, 370 F.Supp. 108, 121-22 (D. Colo. 1973); K. Davis, 1 Administrative Law Treatise, § 5.09 (1959).

[28] APA Legislative History, 79th Cong. (1944-46) at 408.

not "legally binding" because a court is as capable as an agency of defining statutory language on the basis of legislative history and purpose. See *Davis, supra*, § 5.03.[29]

In the case of Revenue Ruling 69-545 defendants cannot pretend that they are only divining what Congress meant when it first included the word "charitable" in the exemption provision of the Internal Revenue Code in 1894.[30] Instead, defendants are responding to what they view as changes in the needs of the poor for health care services. The statute and the legislative history (both of the original act and later amendments) could not adequately guide the IRS in addressing the changed economic, social and political situations which motivated IRS to revise its standards governing charitable hospitals. The ruling embodies complex judgments, not mere statutory construction, and thus is clearly substantive. Those who will be affected by any changes IRS makes can offer IRS insight into what the competing interests are and how they can be reconciled. IRS should and, pursuant to section 553 of the APA, must offer them the opportunity to participate.

Plaintiffs stress that to comply with the APA, IRS must simply publish a notice of proposed rulemaking in the *Federal Register* and allow a period for public comment. This is not an unreasonable burden to impose on the IRS.[31] In the usual case, comments will be

[29] Whether or not a ruling is legally binding does not affect the conduct of a party, except perhaps psychologically. If an individual believes it is invalid, he may just as easily violate a substantive ruling or even a statute, as an interpretative ruling. In all cases, compliance must be sought either in an administrative proceeding or in court.

[30] Act of August 15, 1894, ch. 349, 28 Stat. 553.

[31] Contrary to the intimation of defendants, compliance with the APA does not threaten the current program of IRS letter rulings. Letter rulings are IRS opinions concerning the federal tax consequences of *specific* proposed transactions. The legislative history makes it clear that advisory rulings in particular cases, such as

few and IRS will be the preeminent expert. In the rare instances in which IRS proposals generate numerous responses because of the importance or controversiality of the issues, it is proper that affected persons have an input.

CONCLUSION

For the foregoing reasons the judgment of the United States Court of Appeals for the District of Columbia Circuit should be reversed and the case remanded.

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letter rulings, are not covered by section 553 of the APA. APA Legislative History, 79th Cong. (1944-46) at 355.

* Counsel gratefully acknowledge the assistance of Mary Anne Sullivan, law student intern at the Center for Law and Social Policy.

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